Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the	)	
Telecommunications Act of 1996	)	

NOTICE OF PROPOSED RULEMAKING

Adopted: July 17, 1996 **Released: July 18, 1996**

Comment Date: **August 26, 1996**
Reply Comment Date: **September 10, 1996**

By the Commission:

TABLE OF CONTENTS

I. INTRODUCTION

1. In February 1996, Congress passed and the President signed the "Telecommunications Act of 1996."[1] This legislation makes sweeping changes affecting all consumers and telecommunications service providers. The intent of this legislation is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[2]

2. In this Notice of Proposed Rulemaking ("Notice"), we consider rules to implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the 1996 Act.[3] Those sections address Bell Operating Company ("BOC") and, in some cases,

[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act") to be codified at 47 U.S.C. §§ 151 et seq. (Hereinafter, all citations to the 1996 Act will be to the 1996 Act as it will be codified in the United States Code.) The 1996 Act amended the Communications Act of 1934 ("Communications Act").

[2] See Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. Preamble (1996) (Joint Explanatory Statement); see also 47 U.S.C. § 706(a) (encouraging the deployment of advanced telecommunications capability to all Americans).

[3] 47 U.S.C. §§ 260, 271-76. In other proceedings, we consider regulations to implement the non-accounting safeguard provisions of Sections 271 and 272, and to address cost allocation issues regarding local exchange carrier provision of video programming services. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rulemaking, CC Docket No. 96-149, FCC 96-308 (rel. July 18, 1996) ("BOC In-Region NPRM"); Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, Notice of Proposed Rulemaking, CC Docket No. 96-112, FCC 96-214 (adopted May 10, 1996)("Video Cost Allocation Notice"). We address non-accounting safeguard issues under Sections 260 and 274 through 276 in the following items: Implementation of the Telecommunications Act of 1996: Telemessaging, Electronic Publishing, and Alarm Monitoring Services, Notice of Proposed Rulemaking, CC Docket No. 96-152, FCC 96-310 (rel. July 18, 1996) ("Electronic Publishing Notice") and Implementation of the Pay Telephone Reclassification and

incumbent local exchange carrier provision of particular telecommunications and information services.[4]

3. This proceeding is one of a series of interrelated rulemakings that collectively will implement the 1996 Act. Certain of these proceedings focus on opening markets to entry by new competitors. Other proceedings will establish rules for fair competition in the markets that are opened to competitive entry by the 1996 Act.

4. This Notice focuses on the accounting safeguards that Congress adopted in the 1996 Act to foster the development of robust competition in all telecommunications markets.[5] As discussed more fully below, these safeguards are intended both to protect subscribers to regulated monopoly services provided by the BOCs and, in some cases, other incumbent local exchange carriers against the risk of being forced to "foot the bill" for the carriers' entry into, or continued participation in, competitive services, and to promote competition in new markets by preventing carriers from using their existing market power in local exchange services to obtain an anticompetitive advantage in those new markets the carriers seek to enter.

A. Background

5. The 1996 Act permits the BOCs to engage in previously proscribed activities if the BOCs satisfy certain conditions that are intended to prevent them from misallocating costs of their new ventures to subscribers to local exchange access services and from discriminating against their competitors in these new markets.[6] Other incumbent local

---

Compensation Provisions of the Telecommunications Act of 1996, Notice of Proposed Rulemaking, CC Docket 96-128, FCC 96-254 (rel. June 6, 1996) ("Payphone Notice").

[4] Section II.B.1, infra, provides the statutory definition of incumbent local exchange carrier.

[5] According to Representative Jack Fields, "[C]ongress is decompartmentalizing segments of the telecommunications industry, opening the floodgates of competition through deregulation, and most importantly, giving consumers choice . . . and from these choices, the benefits of competition flow to all of us as consumers -- new and better technologies, new applications for existing technologies, and most importantly . . . lower consumer price." 142 Cong. Rec. H1149 (Feb. 1, 1996) (statement of Rep. Fields).

[6] The MFJ prohibited the BOCs from providing information services, providing interLATA services, or manufacturing and selling telecommunications equipment or manufacturing customer premises equipment ("CPE"). United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983), vacated sub nom. United States v. Western Elec. Co., slip op. CA 82-0192 (D.D.C. Apr. 11, 1996). The theory behind the MFJ was that the BOCs could leverage their market power in the local market to impede competition in the interLATA services, manufacturing, and information services markets. The information services restriction was modified in 1987 to allow BOCs to provide voice messaging services and to transmit information services generated by others. See United States v. Western Elec. Co., 673 F.Supp.

exchange carriers are subject to similar conditions if they elect to enter or continue to participate in certain markets.

6. In lifting or modifying the restrictions on the BOCs, we believe Congress also recognized that BOC entry into in-region interLATA services, manufacturing and other areas raises serious concerns for consumers and competition, even after a BOC has satisfied the requirements for entry. BOCs currently possess market share for local exchange and exchange access in areas where they provide such services of approximately 99.5 percent as measured by revenues.[7] Other incumbent local exchange carriers have similar market shares within their local exchange and exchange access service areas. Under rate-of-return regulation, price caps with sharing (either for interstate or intrastate services), or price caps that may be adjusted in the future, or if its entitlement to any revenues may be affected by the costs that it classifies as regulated, an incumbent local exchange carrier may have an incentive to misallocate to its regulated core business costs that would be properly allocated to its competitive ventures. While the 1996 Act promotes competition and encourages BOC entry, it also prescribes a judicious mix of structural and non-structural safeguards that are intended to protect ratepayers, consumers and competitors against potential cost misallocation and discrimination. Where BOCs already participate in a market, as with alarm monitoring services and payphone services, or where the Act addresses services other incumbent local exchange carriers may provide, the Act requires compliance with similar safeguards. The purpose of this proceeding is to establish accounting safeguards to constrain potential cost misallocation and discrimination against competitors.

7. Although we could prescribe rules that would completely prevent improper cost allocations by enforcing complete separation between regulated telecommunications operations and new activities, we recognize that it would be difficult, if not impossible, to enforce such rules. Moreover, our success might destroy the potential competitive benefits of the economies of scope that BOCs and other incumbent local exchange carriers could realize, benefits that constitute a major incentive for the BOCs and other incumbent local exchange carriers to enter or continue to participate in these markets.[8] Our task in this

---

525 (D.D.C. 1987); United States v. Western Elec. Co., 714 F.Supp. 1 (D.D.C. 1988); 767 F.Supp. 308 (D.D.C. 1991). In 1991, the restriction on BOC ownership of content-based information services was lifted. United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991), stay vacated, United States v. Western Elec. Co., 1991-1 Trade Cases (CCH) 69,610 (D.C.Cir. 1991).

[7] Telecommunications Industry Revenue: TRS Worksheet Data, (Com. Car. Bur. Feb. 1996).

[8] There are economies of scope where it is less costly for a single firm to produce a bundle of goods or services together, than it is for two or more firms, each specializing in distinct product lines, to produce them separately. See, e.g., John C. Panzar and Robert D. Willig, Economies of Scope, 71 American Economic Review of Papers and Proceedings 268 (1981); William J. Baumol, John C. Panzar, and Robert D. Willig, Contestable Markets and the Theory of Industry Structure 71-79 (1982); Daniel F. Spulber, Regulation and

proceeding is to protect against improper cost allocations, while allowing the BOCs and other incumbent local exchange carriers to realize their reasonable competitive advantages and ensuring that the consumers of those carriers' regulated telecommunications services are able to share in the carriers' economies of scope.

8. We expect that once competition exists in the local exchange and exchange access services markets and incumbent local exchange carrier revenues are not dependent on costs, the need for the accounting safeguards proposed in this Notice may vanish. With the advent of competition, we can and will act to eliminate any unnecessary rules. With our adoption of the *Notice of Proposed Rulemaking* to implement Section 251,[9] we have taken a major step to achieve that goal. Reform of other regulations, like price cap rules, jurisdictional separations rules, and the access charge regime, will also move us more quickly toward that goal. In the meantime, while we continue to seek to minimize the burden our rules impose upon those subject to them, we also will ensure that ratepayers and competition remain protected from cost misallocation and anticompetitive discrimination.

B. Specific Considerations

9. The challenge in setting cost allocation rules that prevent subsidization without eliminating legitimate economies of scope arises because there are some costs that cannot be allocated based on economic cost-causation principles. The greater the economies of scope between or among services, the greater the share of costs that cannot be allocated among them on economic cost-causation principles. Given these circumstances, we believe that the rules we develop for allocating these costs should be clear, consistent, and predictable. They should also assure that subscribers to the BOCs' and other incumbent local exchange carriers' core services share in any economies of scope realized when entering those markets from which they were previously barred or continuing to participate in other markets addressed in the 1996 Act. We believe, for example, that a policy that would permit the BOCs to allocate all common costs of shared facilities[10] to regulated services would pose a risk that subscribers to the BOCs' regulated telecommunications services would pay more than the stand-alone costs of the services they receive, and would thus be subsidizing the BOCs' competitive activities rather than sharing in the economies of scope realized because of the BOCs' diversification.

10. It is also essential that the affiliate transactions rules discourage, and

---

Markets 114-15 (1989).

[9] See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Notice of Proposed Rulemaking, FCC 96-182 (April 19, 1996) ("Interconnection NPRM").

[10] Shared facilities refers to those facilities used to provide both regulated and nonregulated services.

facilitate detection of, cost misallocations. Statutory structural separation requirements, like the prohibition on sharing employees or the obligation that all affiliate transactions be "on an arm's length basis," reduce the risk that cost misallocations will accompany BOC entry into manufacturing and interLATA service markets. This protection of ratepayer interests, however, is not cost free. Structural separation restrictions that protect ratepayers also make it more difficult for a BOC or other incumbent local exchange carrier to capture the economies of scope that benefit both regulated and nonregulated service subscribers. Only our success in removing barriers to competition in the BOCs' and other incumbent local exchange carriers' regulated services markets will enable us to remove these restrictions.

11. A threshold question is to what extent, if any, we should rely upon our existing accounting safeguards to achieve our twin goals of protecting subscribers to BOCs' and other incumbent local exchange carriers' regulated telecommunications services against improper cost allocations and competitors against unreasonable discrimination. Those safeguards are found in Parts 32 and 64 of our rules.[11] They consist of cost allocation and affiliate transactions rules[12] that were designed to keep incumbent local exchange carriers from imposing the costs and risks of their competitive ventures on interstate telephone ratepayers, and to ensure that interstate ratepayers share in the economies of scope incumbent local exchange carriers realize when they expand into additional enterprises.[13] As we implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the 1996 Act, for each of these sections, we seek comment on whether our current rules can or should be applied as they are, with some modification, or eliminated. We tentatively conclude that our current rules, with the modifications we describe below, will best meet the statutory requirements of these sections and their underlying goals. We invite comment on this tentative conclusion.

12. In reaching this tentative conclusion, we note our belief that the accounting safeguards this Notice proposes are no more detailed than those in our current rules except where the 1996 Act requires more detailed safeguards or where our experience with current rules has made clear that more detailed safeguards are necessary to prevent improper subsidization. We invite comment on whether less detailed accounting safeguards would suffice to achieve the aims of Sections 260 and 271 through 276 of the 1996 Act. We note that those urging that we adopt more detailed accounting safeguards than those in our current rules or those specifically mandated by the 1996 Act bear a heavy burden of persuading us to adopt such

---

[11] See 47 C.F.R. Parts 32 and 64.

[12] Id. at § 32.27.

[13] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298,1312-14 & 1335 (1987) ("Joint Cost Order"), recon., 3 FCC Rcd 6701 (1988), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

safeguards.

13. The 1996 Act creates opportunities for competitive entry in the local exchange, exchange access, and interLATA telecommunications markets, among others. These opportunities may affect which accounting safeguards we adopt in two apparently countervailing ways. The incumbent local exchange carrier may be reluctant to increase rates for local exchange and exchange access service if the increases would induce competitive entry in the markets in which it would otherwise continue to have market power. This would militate against the adoption of stringent accounting safeguards. On the other hand, a carrier entering or continuing to participate in a nonregulated market will have an increased incentive to shift the costs and risks of its competitive activities to these regulated services if such shifting permits the carrier to increase the rates for these regulated services. The increased rates would not reduce substantially the carrier's market share for local exchange and exchange access service.

14. Several provisions of the 1996 Act prohibit BOCs, or, in some cases, all incumbent local exchange carriers from using their telephone exchange service and exchange access operations to subsidize their competitive ventures.[14] We believe that Congress's primary intent in prohibiting this subsidization was to protect subscribers to these services from increased rates, and seek commenters' help in determining how best to fulfill that intent. We propose that the accounting safeguards we adopt in this proceeding apply to all services for which Sections 260 and 271 through 276 require accounting safeguards.

15. Control over the bottleneck facility may enable a BOC or other incumbent local exchange carrier to engage in predatory behavior. For example, the ability to discriminate in favor of its interexchange affiliate with respect to the price of access (*i.e.*, charging the affiliate a lower access rate than it charges competing IXCs) could facilitate an incumbent local exchange carrier's engaging in a "price squeeze."[15] In such a situation if the incumbent local exchange carrier's interexchange affiliate lowers its retail rate to reflect its unfair cost advantage, competing IXCs would be forced either to match the price reduction and decrease their profit margins, or to maintain their retail prices at preexisting levels and lose market share (and therefore profits).[16]

[14] See, e.g., 47 U.S.C. §§ 254(k), 260(a)(1), 272(b)(5), 272(c)(2), 274(b)(4), 275(b)(2), and 276(a)(1).

[15] See, e.g., Paul L. Joskow, Mixing Regulatory and Antitrust Policies in the Electric Power Industry: The Price Squeeze and Retail Market Competition, in F.M. Fisher, ed., Antitrust and Regulation: Essays in Memory of John J. McGowan 173-239 (1985); Martin K. Perry, Vertical Integration: Determinants and Effects in Handbook of Industrial Organization (Richard Schmalemsee and Robert Willig eds. 1989) at 243, and T.G Krattenmaker and S.C. Salop, Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price, 96 Yale L.J. 96, 209-93 (1986).

[16] Equivalently, the BOC could maintain its retail price but increase the rates charged to IXCs. IXCs would then face decreased profit margins if they maintained retail rates or a decrease in market share if it raised retail rates.

As a practical matter, an incumbent local exchange carrier can achieve the same result by charging the same price for access to all interexchange providers, while providing a higher quality of service[17] to its affiliate than to competing IXCs. In this case, an IXC that attempted to match the incumbent local exchange carrier affiliate's retail price would lose market share since its lower quality of access would mean that it would be offering a lower quality of interexchange service.[18] A third type of potentially anticompetitive, discriminatory behavior occurs when an incumbent local exchange carrier discriminates in favor of its affiliates when purchasing goods or services. For example, to the extent that the incumbent local exchange carrier is the predominant purchaser of telecommunications equipment that is used in the local exchange network, purchasing such equipment only from its affiliate manufacturing entity could adversely effect the ability of a competitor to operate profitably.

16. We also note that a carrier subject to rate-of-return regulation may have an incentive to engage in predatory pricing, if losses from below-cost pricing in the competitive market can be shifted to its regulated cost of service.[19] We expect, however, that such predatory pricing by a BOC or other incumbent local exchange carrier is unlikely to occur. First, while an incumbent local exchange carrier may possess the legal ability to raise rates in the regulated market to subsidize its competitive activities, the threat of entry into the regulated market may prevent it from doing so. Even if such subsidization were to allow a BOC or other incumbent local exchange carrier to sustain prices below costs for a period of time sufficient to drive out competing IXCs, the local exchange carrier would be unlikely to raise prices above the competitive level, since each IXC's network represents an embedded facility which could be purchased in a bankruptcy proceeding and used if the local exchange carrier affiliates subsequently attempted to raise prices above the competitive level. We invite comment on the extent to which the opportunities to engage in predatory behavior should affect our decisions in this proceeding.

C. Overview of Sections 260 and 271 through 276

17. In Sections 260 and 271 through 276, Congress delineated the conditions under which incumbent local exchange carriers would be permitted to offer telemessaging and alarm monitoring services and under which BOCs would be permitted to manufacture and sell

[17] Service quality has many parameters. They include the speed at which orders are filled, the percentage of calls that go through on the first attempt to the called party, the response time when outages occur, and noise level.

[18] See Interconnection NPRM at para 63 (addressing Section 251(c)(2)(C)).

[19] BOCs that are regulated under a price cap regime with sharing will have a similar set of incentives. We discuss these concepts in Section IV.A., infra.

telecommunications equipment, to manufacture customer premises equipment, and to offer interLATA telecommunications, information, alarm monitoring and payphone services. In some cases, separate affiliates are required. In other cases, integrated operation is permitted.

18. Section 260 provides that an incumbent local exchange carrier, including a BOC, that provides telemessaging service "shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access," but does not require a separate affiliate.[20]

19. Section 271(b) authorizes the BOCs to provide "out-of-region" interLATA services as of February 8, 1996, even if the services terminate within the BOC's region, and "in-region" interLATA services upon Commission approval.[21] Section 271(g) lists specific "incidental interLATA services"[22] that BOCs and their affiliates may provide after February 8, 1996.[23] Section 271(h) states that "[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[24]

20. Section 272 permits a BOC (including any affiliate) that is an incumbent local exchange carrier to manufacture equipment (as defined in the AT&T consent decree),[25] originate in-region interLATA telecommunications services, other than incidental and previously authorized interLATA services, and provide certain interLATA information services[26] only if it does so through one or more separate affiliates. Each of the separate affiliates must "maintain [separate] books, records, and accounts in the manner prescribed by the Commission" and "shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis."[27] In its dealings with the separate affiliate, each BOC must "account for all

---

[20] 47 U.S.C. § 260(a)(1).

[21] 47 U.S.C. § 271(b) & (d)(3). "In-region services" refers to the provision by "[a] Bell operating company, or any affiliate of that Bell operating company, . . . [of] interLATA services originating in any of its in-region States . . . if the Commission approves the application of such company for such State . . . ." Id. at § 271(b)(1).

[22] Id. at § 271(g).

[23] Id. at § 271(b).

[24] Id. at § 271(h).

[25] Id. at § 273(h).

[26] Id. at § 272(a)(2)(B) & (C).

transactions . . . in accordance with accounting principles designated or approved by the Commission."[28]

21. Section 273(d)(3) sets forth an additional separate affiliate requirement for manufacturing of telecommunications equipment and customer premises equipment by entities that certify the same class of telecommunication equipment and customer premises equipment produced by unaffiliated entities.[29]

22. Section 274(a) prohibits any "Bell operating company or any affiliate [from] engag[ing] in the provision of electronic publishing that is disseminated by means of such Bell operating company's or any of its affiliates' basic telephone service," other than through "a separated affiliate or electronic publishing joint venture."[30] This separated affiliate or electronic publishing joint venture must, among other requirements, "maintain separate books, records, and accounts and prepare separate financial statements."[31]

23. Section 275(b)(2) bars an incumbent local exchange carrier that provides alarm monitoring services from "subsidiz[ing] its alarm monitoring services either directly or indirectly from telephone exchange service operations," but does not require a separate affiliate.[32]

24. Section 276(b)(1)(C) directs the Commission to prescribe rules for BOC payphone service that, "at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding."[33] Section 276(a)(1)

---

[27] Id. at § 272(b)(2) and (5).

[28] Id. at § 272(c)(2).

[29] Id. at § 273(d)(3).

[30] Id. at § 274(a).

[31] Id. at § 274(b)(1).

[32] Id. at § 275(b)(2).

[33] Id. at § 276(b)(1)(C); see also Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer III), CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) ("Phase I Order"), recon., 2 FCC Rcd 3035 (1987) ("Phase I Recon. Order"), further recon., 3 FCC Rcd 1135 (1988) ("Phase I Further Recon. Order"), second further recon., 4 FCC Rcd 5927 (1989) ("Phase I Second Further Recon."), Phase I Order and Phase I Recon. Order vacated, California v. FCC, 905 F.2d 1217 (9th Cir. 1990) ("California I"); Phase II, 2 FCC Rcd 3072 (1987) ("Phase II Order"), recon., 3 FCC Rcd 1150 (1988) ("Phase II Recon. Order"), further recon., 4 FCC Rcd 5927 (1989) ("Phase II Further Recon. Order"), Phase II Order, vacated, California I, 905 F.2d 1217 (9th Cir. 1990); Computer III Remand Proceedings, 5 FCC Rcd 7719 (1990) ("ONA Remand Order"),

provides that, after the effective date of those rules, any BOC that provides payphone service "shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations."[34]

25. Section 254(k) prohibits a telecommunications carrier from "us[ing] services that are not competitive to subsidize services that are subject to competition."[35] Section 254(k) further states that "[t]he Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[36]

D. Structure of this Notice

26. Section II of this Notice discusses accounting safeguards that would apply when an incumbent local exchange carrier, including a BOC, provides a service addressed in Sections 260 and 271 through 276 of the 1996 Act on an integrated, or in-house, basis. For the provision of services on an integrated basis, we tentatively conclude in Section II that our existing Part 64 cost allocation rules generally satisfy the 1996 Act's accounting safeguards requirements. Section III discusses accounting safeguards that would apply when an incumbent local exchange carrier, including a BOC, uses an affiliate to provide a service addressed in Sections 260 and 271 through 276 of the 1996. In Section III, we tentatively conclude that, except where the 1996 Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the statute's requirement of accounting safeguards when an incumbent local exchange carrier conducts transactions with its affiliate. In that section, we do propose several modifications to the affiliate transactions rules to provide greater protection against improper subsidization. Within Sections II and III, subsections discuss issues related to the application of the individual statutory sections. In Section IV of this Notice, we seek comment on whether and, if so, how price cap regulation alters the need for accounting safeguards to ensure against the subsidization of services permitted under Sections 260 and 271

---

recon., 7 FCC Rcd 909 (1992), pets. for review denied, California v. FCC, 4 F.3d 1505 (9th Cir. 1993) ("California II"); Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571 (1991) ("Computer III Remand"); BOC Safeguards Order vacated in part and remanded, California v. FCC, 39 F.3d 919 (9th Cir. 1994) ("California III"), cert. denied, 115 S.Ct. 1427 (1995).

[34] 47 U.S.C. § 276(a)(1).

[35] Id. at § 254(k).

[36] Id.

through 276 of the 1996 Act with revenues from regulated telecommunications services. In that same section, we seek comment on whether our proposals in this Notice satisfy the requirements of Section 254(k).[37]

II. SAFEGUARDS FOR INTEGRATED OPERATIONS

A. General

27. In this section, we discuss the provisions in Sections 260, 271, 275, and 276 of the 1996 Act relating to accounting safeguards for telemessaging, certain interLATA telecommunications and information, alarm monitoring, and payphone services that the BOCs and other incumbent local exchange carriers might be permitted to provide on an integrated basis (*i.e.*, within the telephone operating companies). We tentatively conclude that our existing Part 64 cost allocation rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services. We invite comment on this tentative conclusion.

28. We developed the cost allocation rules in our *Joint Cost* and *Computer III Proceedings* to help ensure that interstate ratepayers do not bear the costs and risks of the telephone companies' nonregulated activities.[38] These rules prescribe how carriers separate the costs of activities regulated under Title II of the Communications Act of 1934, as amended, from the costs of nonregulated activities, where the nonregulated activities are performed directly by the carrier rather than through an affiliate.[39] Under these rules, incumbent local exchange carriers may not assign the costs of nonregulated activities to regulated products and services. Incumbent local exchange carriers have implemented internal cost allocation systems to help ensure their compliance with these rules. Redesigning these internal systems to accommodate a fundamentally different cost allocation approach might impose substantial administrative and financial costs on the carriers. We seek comment on whether the benefits of a fundamentally different approach to cost allocation would be outweighed by the costs that implementation of

---

[37] Id.

[38] These rules, along with the affiliate transactions requirements in Section 32.27 of the Commission's rules, represent the nonstructural accounting safeguards adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding referred to in the 1996 Act. See 47 U.S.C. § 276(b)(1)(C).

[39] By nonregulated activities, we mean activities not regulated under Title II of the Communications Act or equivalent state statutes. This category generally consists of: activities that have never been subject to regulation under Title II; activities subject to Title II regulation that we have preemptively deregulated; and activities subject to Title II regulation that have been deregulated at the interstate level, but not preemptively deregulated, that we decide should be classified as nonregulated activities for Title II accounting purposes. See 47 C.F.R. § 32.23(a).

such a system would entail. Alternatively, we invite comment on whether, and how, we might adapt the existing cost allocation system to accommodate any or all of the services we address in Section II.B, below.

B. Specific Services

1. Section 260 - Telemessaging Service

a. Statutory Language

29. Section 260(a)(1) of the 1996 Act prohibits each "local exchange carrier subject to the requirements of section 251(c) that provides telemessaging service [from] subsidiz[ing] its telemessaging service directly or indirectly from its telephone exchange service or its exchange access."[40] Section 251(c), in turn, applies to every "incumbent local exchange carrier."[41] Section 260(c) defines "telemessaging service" as "voice mail and voice storage and retrieval services, any live operator services used to record, transcribe, or relay messages (other than telecommunications relay services), and any ancillary services offered in combination with these services."[42] The principal goal of the prohibition against subsidization in Section 260(a)(1) appears to be to ensure that the telemessaging service operations of incumbent local exchange carriers do not result in increased rates for telephone exchange service and exchange access. Section 260(b) also requires the Commission to establish procedures for expedited consideration of any complaint alleging "material financial harm to a provider of telemessaging service."[43] In

---

[40] 47 U.S.C. § 260(a)(1).

[41] Id. at § 251(c). Section 251(h)(1) of the 1996 Act defines "an incumbent local exchange carrier" as:

> the local exchange carrier, with respect to an area, that--
>
> (A) on the date of enactment of the Telecommunications Act of 1996, provided telephone exchange service in such area; and
>
> (B)(i) on such date of enactment, was deemed to be a member of the exchange carrier association pursuant to section 69.601(b) of the Commission's regulations (47 C.F.R. 69.601(b)); or
>
> (ii) is a person or entity that, on or after such date of enactment, became a successor or assign of a member described in clause (i). Id. at § 251(h)(1).

[42] 47 U.S.C. § 260(c).

providing for this expedited consideration, Congress intended to protect providers of telemessaging service that are not themselves, or affiliated with, incumbent local exchange carriers against subsidization.

30. Our present Part 64 rules classify telemessaging service as a nonregulated activity for Title II accounting purposes.[44] Consequently, provision of telemessaging services is already governed by our Part 64 rules and, to the extent telemessaging is provided through affiliates, our affiliate transactions rules also apply.[45] Our Part 64 rules require carriers to use a cost allocation methodology based on fully distributed costs ("FDC").[46] This methodology establishes a hierarchy of cost apportionment rules designed to prevent subsidies. These rules are applied to costs recorded in the accounts specified in the Uniform System of Accounts ("USOA") set out in Part 32 of our rules.[47] The methodology requires carriers to assign costs directly, wherever possible, to regulated or nonregulated activities.[48] If costs cannot be directly assigned, they are considered "common costs" and must be placed in homogeneous cost pools. The carrier must then divide the costs in each pool between regulated and nonregulated activities using formulas or factors known as "allocators." Depending upon the information available, carriers must apply these allocators in the following order. Whenever possible, common costs must be directly attributed based upon a direct analysis of the origins of those costs. Common costs that cannot be directly attributed must be indirectly attributed based on an indirect, but cost-causative,

---

[43] Id. at § 260(b); see Joint Explanatory Statement at 138 (expedited procedures to apply to "complaints alleging discrimination or cross-subsidization that result[s] in material financial harm to providers of telemessaging service").

[44] Incumbent local exchange carriers may provide telemessaging services either directly or through an affiliate. Among the BOCs, Pacific Bell ("Pacific") and Southwestern Bell Telephone Company ("SBT") already offer these services through nonregulated affiliates, while the remaining five BOCs provide them directly through their regulated telecommunications carriers.

[45] The Commission has adopted a comprehensive system of accounting safeguards now found in Parts 32 and 64 of our rules. These requirements apply not only to the BOCs, but to all incumbent local exchange carriers with annual operating revenue of $100 million or more. Smaller incumbent local exchange carriers, other than average schedule companies, must comply with accounting rules, cost allocation standards, and affiliate transactions rules and are subject to Commission audit. Computer III Remand, 6 FCC Rcd at 7591. See 47 C.F.R. §§ 64.901, 64.902, and 64.903.

[46] A fully distributed costing system allocates all of the costs of a group of services among those services using direct assignment and allocation factors based on relative use or estimates of relative use. The assignments and allocations determine each service's share of total cost. See MCI Telecommunications Corp. v. FCC, 675 F.2d 408, 410 (D.C. Cir. 1982); Joint Cost Order, 2 FCC Rcd at 1312-13, paras. 109-17.

[47] 47 C.F.R. Part 32.

[48] Costs are directly assigned when they can be traced to a service or activity without the use of an allocator.

linkage to another cost pool or pools for which a direct assignment or attribution is possible.[49] Only if direct or indirect attribution factors are not available may the carrier allocate a pool of common costs using what is known as a "general allocator." For regulated activities, the general allocator is expressed as the ratio of all expenses directly assigned or attributed to regulated activities (numerator) to all expenses directly assigned or attributed to both regulated and nonregulated activities (denominator).

31. Our Part 64 cost allocation rules also require incumbent local exchange carriers to allocate their network investment plant between activities that we regulate under Title II and nonregulated activities. This allocation must be based on the peak "relative regulated and nonregulated usage" projected for the network plant over a three-year period.[50] BOC provision of telemessaging service may result in the reallocation of this plant from regulated to nonregulated activities. In the *Joint Cost Proceeding*, we determined that, absent waiver, any such reallocation "must be made at undepreciated baseline cost and must include interest calculated at the authorized interstate rate of return."[51]

32. Section 64.901(b)(4) of our rules requires a carrier at the beginning of each calendar year to forecast peak relative nonregulated use of jointly-used network plant over a three-year period.[52] The relative split between usage for activities regulated under Title II and nonregulated usage at the point in time when nonregulated usage is greatest in comparison to regulated defines the allocation factor to be applied. If application of this method would increase the allocation to nonregulated activities for any account from the previous year, the carrier must make the reallocation.[53] If application of this method would decrease the allocation to

---

[49] "Direct attribution occurs when common costs are allocated between regulated and nonregulated activities based on direct measures of cost-causation or direct analysis of the origin of the costs themselves. For example, if motor vehicle investment is apportioned between regulated and nonregulated based on analysis of the usage of those motor vehicles, the costs are directly attributed. Indirect attribution occurs when common costs are allocated between regulated and nonregulated activities based on indirect measures of cost-causation. For example, if investment in garage work equipment is apportioned between regulated and nonregulated activities in proportion to the overall apportionment of motor vehicle investment, the costs are indirectly attributed." Implementation of Further Cost Allocation Uniformity, Order Inviting Comments, 7 FCC Rcd 6688, 6689 (Com. Car. Bur. 1992).

[50] 47 C.F.R. § 64.901(b)(4).

[51] Joint Cost Reconsideration Order, 2 FCC Rcd at 6285, para. 17 (footnote omitted). We defined "baseline cost" as "the depreciated original cost at the time the equipment was initially placed in joint use or the original cost of new plant." Id. at 6311, n.32.

[52] 47 C.F.R. §64.901.

nonregulated activities for that account from the previous year, the carrier must obtain a waiver to make the reallocation. At the end of the year, the carriers compare their forecasts with actual usage. If the actual usage of nonregulated activities is greater, they must adjust the allocation to nonregulated services based on that actual usage.[54]

33. We tentatively conclude that applying our Part 64 rules to telemessaging will safeguard against the subsidies prohibited by Section 260(a)(1). Section 260 appears to allow telemessaging service to be provided on an integrated basis, at least for most incumbent local exchange carriers. However, we tentatively conclude, as we do in our companion item, *BOC In-Region NPRM*, that telemessaging is an information service. We also tentatively conclude in that *NPRM*, that our authority under Sections 271 and 272 over interLATA information services applies to intrastate, interLATA information services provided by BOCs or their affiliates.[55] BOC provision of telemessaging service on an interLATA basis would therefore be subject to the separate affiliate and other requirements of Section 272.[56] We invite comment on these tentative conclusions.

b. Scope of Commission's Authority

34. Section 260 of the Act imposes additional safeguards regarding the provision of telemessaging services, not only on the BOCs, but on all incumbent local exchange carriers.[57] We seek comment on whether, in light of our tentative conclusion that Sections 271 and 272 give the Commission jurisdiction over intrastate interLATA information services including telemessaging, Section 260 should also be read to give us jurisdiction over intrastate information services in implementing and enforcing Section 260. We note, however, that unlike Sections 271 and 272, the scope of Section 260 is not limited to interLATA services, nor is it limited to the BOCs. We seek comment, therefore, on whether any such intrastate jurisdiction would extend only to the BOCs, as only BOCs are covered by Sections 271 and 272, or to all incumbent local exchange carriers.

35. We further seek comment on what role States might have in implementing Section 260(a)(1)'s prohibition against subsidization of "telemessaging service directly or

---

[53] A carrier must reflect any reallocation of network plant in the forecast report that accompanies its proposed access tariffs for the next calendar year. See Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules), 3 FCC Rcd 3762, 3763 (Com. Car. Bur. 1988).

[54] See Joint Cost Reconsideration Order, 2 FCC Rcd at 6290-91, paras. 64-70.

[55] BOC In-Region NPRM at para. 21.

[56] Id. at para. 54. For a more complete discussion of this issue, see Section III.B.4, infra.

[57] 47 U.S.C. § 260.

indirectly from . . . telephone exchange service or . . . exchange access." Prior to the enactment of the 1996 Act, we did not preempt States from using their own cost allocation procedures for intrastate purposes.[58] We ask commenters to address whether we must change this policy in order to effectuate Section 260.

36. To ensure a complete record, if Section 260 does not itself apply to intrastate services, we also seek comment on whether we have authority to preempt State regulation with respect to the accounting matters addressed by Section 260 pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority.[59] We tentatively conclude that if Section 260 does not apply to intrastate services and if we have authority to preempt pursuant to *Louisiana PSC*, we should refrain from exercising that authority in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular, whether preemption pursuant to *Louisiana PSC* in this area would be necessary to achieve the intent behind Section 260(a)(1) or whether less intrusive measures would be sufficient.

2. Section 271 - InterLATA Telecommunications Services

a. Incidental InterLATA Services

37. Section 271(h) states that "[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[60] Section 271(g) lists specific incidental interLATA services[61] that the BOCs and their affiliates may provide after the date of enactment of the 1996 Act.[62] Those services are:

> the interLATA provision by a Bell operating company or its

[58] Joint Cost Order, 2 FCC Rcd at 1310, paras. 88-93; id. at 1335-36, para. 293. See also Detariffing the Installation and Maintenance of Inside Wiring, Third Report and Order, 7 FCC Rcd 1334, 1339-40 (1982)(states free to depart from federal accounting safeguards regarding simple inside wiring if they choose to regulate prices for simple inside wiring services).

[59] Louisiana Public Service Comm'n, 476 U.S. 355, 375 n.4 (1986) ("Louisiana PSC").

[60] 47 U.S.C. § 271(h).

[61] Id. at § 271(g).

[62] Id. at § 271(b)(3).

affiliate--

(1)(A) of audio programming, video programming, or other programming services to subscribers to such services of such company or affiliate;

(B) of the capability for interaction by such subscribers to select or respond to such audio programming, video programming, or other programming services;

(C) to distributors of audio programming or video programming that such company or affiliate owns or controls, or is licensed by the copyright owner of such programming (or by an assignee of such owner) to distribute; or

(D) of alarm monitoring services;

(2) of two-way interactive video services or Internet services over dedicated facilities to or for elementary and secondary schools as defined in section 254(h)(5);

(3) of commercial mobile services in accordance with section 332(c) of this Act and with the regulations prescribed by the Commission pursuant to paragraph (8) of such section;

(4) of a service that permits a customer that is located in one LATA to retrieve stored information from, or file information for storage in, information storage facilities of such company that are located in another LATA;

(5) of signaling information used in connection with the provision of telephone exchange services or exchange access by a local exchange carrier; or

(6) of network control signaling information to, and receipt of such signaling information from, common carriers offering interLATA services at any location within the area in which such Bell operating company provides telephone exchange services or

exchange access.[63]

Section 271(h) states that "[t]he provisions of [Section 271(g)] are to be narrowly construed. The interLATA services provided under subparagraph (A), (B), or (C) of [Section 271(g)(1)] are limited to those interLATA transmissions incidental to the provision by a Bell operating company or its affiliate of video, audio, and other programming services that the company or its affiliate is engaged in providing to the public."[64]

38. Section 271(h) states that "[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[65] We invite comment on whether our present cost allocation rules in Part 64 are adequate to prevent the adverse effects proscribed by Section 271(h) or whether alternative solutions, if any, would be more appropriate. We ask commenters asserting that the rules require modifications to describe in detail the modifications they believe necessary, to explain how these modifications or additions to our Part 64 rules would better enable the Commission to fulfill its obligations under Section 271(h), and to identify the category of ratepayers or competitive markets the proposed modifications or additions would protect.

b. Integrated Provision of InterLATA Services

39. We note that BOCs are permitted to provide certain regulated, interLATA telecommunications services on an integrated basis, including out-of-region services and certain types of incidental services.[66] In our *BOC Out-of-Region Order*,[67] we determined that the BOCs must provide out-of-region interstate, interexchange services (including interLATA and intraLATA services) through separate affiliates, at least on an interim basis, in order to qualify for nondominant regulatory treatment in the provision of those services. Under that *Order*, however, a BOC could still choose to provide these services on an integrated basis, subject to dominant carrier regulation. To ensure against improper subsidization in the event of such operations, we tentatively conclude that we should apply our cost allocation rules to regulated

[63] Id.

[64] Id. at § 271(h).

[65] Id.

[66] Id. at § 272(a)(2)(B).

[67] Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, Report and Order, CC Docket No. 96-21, FCC 96-288 (July 1, 1996) ("BOC Out-of-Region Order").

services other than local exchange and exchange access services provided on an integrated basis. We seek comment on this tentative conclusion and on whether we should develop modified cost allocation rules for these other regulated services that the BOCs may provide on an integrated basis to prevent allocation of the costs of these other regulated services to local exchange and exchange access customers and, if so, what these modifications should be.[68] One possible solution would be to require BOCs to create a separate category for regulated services other than local exchange and exchange access services within their internal cost allocation systems. This category would be in addition to the regulated and nonregulated categories our existing rules require and would parallel the approach we took with respect to video dialtone.[69] Alternatively, we could require BOCs to classify any regulated services other than local exchange and exchange access services they provide on an integrated basis as nonregulated activities for Title II accounting purposes. This would parallel the approach we took in the *BOC Out-of-Region Order*[70] and would result in the carriers' allocating the costs of these services to the nonregulated category.[71] We invite comment on the relative costs and benefits of these approaches.

40. In our *Interexchange Notice*,[72] we addressed whether we should modify or eliminate the separation requirements independent local exchange carriers must currently meet in order to qualify for non-dominant treatment when they offer interstate, interexchange services originating outside the areas in which they control local access facilities.[73] We also sought comments on whether, if we modified or eliminated these separation requirements for non-dominant treatment of independent local exchange carriers, we should apply the same requirements to BOC provision of out-of-region interstate, interexchange services.[74] If

---

[68] In Section III.B.4, infra, we seek comment on whether we should apply our affiliate transactions rules to transactions between the BOCs and any of their affiliates engaged in activities, other than out-of-region interLATA services, that are permitted under Section 271 of the 1996 Act.

[69] Telephone Company-Cable Television Cross Ownership Rules, Sections 63.54-63.58, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, 326 (1994).

[70] BOC Out-of-Region Order at paras. 38-40, supra (treating out-of-region interstate, interexchange services provided by BOC affiliates as nonregulated for accounting purposes).

[71] InterLATA services provided by LECs other than the BOCs have been treated as nonregulated services for Title II accounting purposes.

[72] Policy and Rules Concerning the Interstate, Interexchange Marketplace, Notice of Proposed Rulemaking, CC Docket No. 96-61, FCC 96-123 (Mar. 25, 1996) ("Interexchange Notice").

[73] Id. at para. 4.

[74] Id. at para. 61.

independent local exchange carriers are allowed to, and choose to, provide out-of-region interstate interexchange services on an integrated basis, we seek comment on whether our regulatory treatment for such incumbent local exchange carriers should be similar to the regulatory treatment we adopt for the BOCs.

c. Other Matters

41. Section 272(e)(3) requires that "[a] Bell operating company . . . impute to itself (if using [exchange] access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers for such service."[75] In our *BOC In-Region NPRM*, we seek comment on how to determine the imputed exchange access charges under Section 272(e)(3).[76] We now invite comment on how the BOCs should account for these imputed access charges. One possible approach would be for the BOCs to record these imputed exchange access charges as an expense that would be directly assigned to nonregulated activities with a credit to the regulated exchange access revenue account. We seek comment on this approach as well as suggested alternatives.

42. Section 272(e)(4) states that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."[77] Although Sections 272(e)(3) and (e)(4) do not address activities performed on an integrated basis, we invite comment on whether and, if so, how these requirements should affect our rules for allocating costs between activities regulated under Title II and nonregulated activities for those BOCs that provide interLATA services on an integrated basis. We request comment on whether, in view of Section 272(e)(4), we may require BOCs that provide interLATA or intraLATA facilities or services on an integrated basis to provide them to their own internal operation only at the same rates as those facilities or services are made available to all carriers. When those rates differ for different carriers, we seek comment on which rate should be the one that applies to BOC affiliate transactions. We also invite comment on whether we should adopt specific accounting procedures to address the difference, if any, between those rates and "the costs [that would be] appropriately allocated" for the underlying facilities or services.[78]

---

[75] 47 U.S.C. § 272(e)(3) (emphasis added).

[76] BOC In-Region NPRM at para. 88.

[77] 47 U.S.C. § 272(e)(4).

[78] Id.

d. Scope of Commission's Authority

43. In the *BOC In-Region NPRM*, we tentatively conclude that this Commission has jurisdiction under Sections 271 and 272 over both interstate and intrastate interLATA services and interLATA information services.[79] That tentative conclusion leads us also to conclude tentatively that we have jurisdiction with respect to accounting matters under those same sections of the 1996 Act. We base our tentative conclusions in the *BOC In-Region NPRM* and in this Notice on the following analysis. Sections 271 and 272 by their terms address BOC provision of "interLATA" services and information services. Many States contain more than one LATA,[80] and thus, interLATA traffic may be either interstate or intrastate.[81] Accordingly, we must determine whether Sections 271 and 272, and our authority pursuant to those sections, apply only to interstate interLATA services and interLATA information services, or to both interstate and intrastate interLATA services and interLATA information services.

44. The MFJ, when it was in effect, governed BOC provision of both interstate and intrastate services. The 1996 Act provides:

> Any conduct or activity that was, before the date of enactment of this Act, subject to any restriction or obligation imposed by the [MFJ] shall, on and after such date, be subject to the restrictions and obligations imposed by the Communications Act of 1934 as amended by this Act and shall not be subject to the restrictions and the obligations imposed by [the MFJ].[82]

This section supersedes the MFJ, and explains that the Communications Act is to serve as its replacement. In the *BOC In-Region NPRM*, we find that Sections 271 and 272 of the Act were intended to replace the MFJ as to both interstate and intrastate interLATA services and interLATA information services.

45. Although Sections 271 and 272 make no explicit reference to interstate and intrastate services, they do refer to a different geographic boundary -- the LATA, as

---

[79] See BOC In-Region NPRM at para. 25.

[80] The state of Texas, for example, contains sixteen BOC LATAs. Local Exchange Routing Guide § 3, at 4.

[81] For example, a call from San Francisco to Los Angeles is an intrastate interLATA call. Approximately 30 percent of interLATA traffic in 1994 was intrastate. See Industry Analysis Division, Telecommunications Industry Revenue: TRS Fund Worksheet Data, Table 6 (Com. Car. Bur. Feb. 1996).

[82] 47 U.S.C. § 152 (codified as a note following Section 2 of the Communications Act, as amended).

originally defined by the MFJ and now by the 1996 Act. In the *BOC In-Region NPRM*, we tentatively conclude that the interLATA/intraLATA distinction appears to have supplanted the traditional interstate/intrastate distinction for purposes of these sections.

46. As to interLATA services, the MFJ prohibited the BOCs and their affiliates from providing any interLATA services, interstate or intrastate, unless specifically authorized by the MFJ or a waiver thereunder.[83] Reading Sections 271 and 272 as applying to all interLATA services fits well with the structure of the statute as a whole. Sections 251 and 252 of the Act establish rules and procedures for competitive entry into local exchange markets. In the *Interconnection NPRM*, we tentatively concluded that Congress intended these sections to apply to both interstate and intrastate aspects of interconnection.[84] These new obligations imposed on BOCs (as well as other incumbent local exchange carriers), and enacted at the same time as Sections 271 and 272, clearly are part of the process for entry into the interLATA marketplace. Indeed, BOCs are permitted to provide in-region interLATA services only after they have met the requirements of Section 271, including a competitive checklist requiring compliance with certain provisions in Sections 251 and 252.[85]

47. In the *BOC In-Region NPRM*, we note also that the structure of Sections 271 and 272 themselves indicates that these sections were intended to address both interstate and intrastate interLATA services. For instance, BOCs are directed to apply for interLATA entry on a state-by-state basis, and the Commission is directed to consult with the relevant State Commission before making any determination with respect to an application in order to verify the BOC's compliance with the requirements for providing in-region interLATA services.[86] As we believe it did in Sections 251 and 252, Congress appears to have put in place rules to govern both interstate and intrastate services, and to have provided a role for both the Commission and the States in implementing those rules.

48. We also note in the *BOC In-Region NPRM* that, by contrast, reading Sections 271 and 272 as limited to the provision of interstate services would mean that the BOCs would have been permitted to provide in-region, intrastate, interLATA services upon enactment and without any guidance from Congress as to entry requirements or safeguards, subject only to any pre-existing State rules on interexchange entry. Any such rules, presumably, would not have been directed at BOC entry, which had for many years been prohibited. Concerns about BOC

---

[83] United States v. Western Elec. Co., 552 F. Supp. 131, 227 (D.D.C. 1982) (subsequent history omitted).

[84] Interconnection NPRM at para. 25.

[85] 47 U.S.C. § 271(c).

[86] Id. at § 271(d)(2)(B).

control of bottleneck facilities over the provision of in-region interLATA services are equally important for both interstate and intrastate services. Thus, the reasons for imposing the procedures and safeguards of Sections 271 and 272 apply equally to the BOCs' provision of both intrastate and interstate, in-region, interLATA services. We found it implausible that Congress could have intended to lift the MFJ's ban on BOC provision of interLATA services without making any provision for orderly entry into intrastate interLATA services, which constitute approximately 30 percent of interLATA traffic.[87] Based on the preceding analysis, we tentatively conclude that our authority under Sections 271 and 272 applies to both intrastate and interstate interLATA services and interstate and intrastate interLATA information services provided by the BOCs or their affiliates. We also stated our belief that Section 2(b) of the Communications Act did not require a contrary result because Congress enacted Sections 271 and 272 after Section 2(b) and squarely addressed the issues presented here. We reach the same tentative conclusion here as to accounting safeguards and seek comment on it.

49. We also invite comment on what role States might play in implementing the accounting safeguards provisions of Sections 271 and 272, given this tentative conclusion. We ask commenters to address whether we must change our policy, adopted prior to the enactment of the 1996 Act, of not preempting States from using their own cost allocation procedures for intrastate purposes.[88] We also invite comment on whether, in enacting the accounting safeguards provisions of Sections 271 and 272, Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures in their regulation of "charges . . . for or in connection with intrastate communications service[s]."[89]

50. To the extent commenters disagree with the above analysis, we also seek comment on whether we have authority to preempt state regulation with respect to the accounting matters addressed by Sections 271 and 272 pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority.[90] We tentatively conclude that if Sections 271 and 272 do not provide authority over intrastate interLATA services and intrastate interLATA information services and if we have authority to preempt pursuant to *Louisiana PSC*, we should refrain from exercising it in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular, whether preemption in this area would be necessary to achieve the intent behind the accounting safeguards provisions of Sections

---

[87] See BOC In-Region NPRM at para. 25.

[88] Joint Cost Order, 2 FCC Rcd at 1310, paras. 88-93; id. at 1335-36, para. 293.

[89] See 47 U.S.C. § 152(b).

[90] Louisiana PSC, 476 U.S. at 375 n.4.